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STATEMENT OF
JOHNNY C. FINCH, SENIOR ASSOCIATE DIRECTOR
GENERAL GOVERNMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE HOUSE COMMITTEE ON WAYS AND MEANS
ON THE ADMINISTRATION'S FISCAL YEAR 1987 BUDGET REQUEST
FOR THE
INTERNAL REVENUE SERVICE



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist your Subcommittee in considering the Administration's fiscal year 1987 budget request for the Internal Revenue Service (IRS). Our testimony is based primarily on the experience we have gained from conducting audits of tax administration operations and activities over the past several years.

In discussing the proposed budget for fiscal year 1987, we will also address the fiscal year 1986 supplemental appropriation request now awaiting congressional action. That supplemental calls for increasing IRS' staffing by 6,950 average positions and increasing its funding by \$340 million, about \$157 million of which is to offset reductions occasioned by the Gramm-Rudman-Hollings Act. The fiscal year 1987 budget request builds on the 1986 supplemental by seeking to further increase IRS' staffing by 1,360 average positions (to a total of 95,084 average positions) and its funding by about \$272 million (to a total of about \$4.1 billion). Together, the supplemental appropriation and the 1987 budget request provide for a 10-percent increase in the staffing level and a 12-percent increase in the funding level currently authorized by the Congress for fiscal year 1986.

In my testimony today, Mr. Chairman, I want to emphasize four points that this Subcommittee should consider in evaluating IRS' request for additional resources.

--First, we believe that the funding increases called for by the 1986 supplemental and the 1987 budget request are warranted. That opinion is based on a consideration of such factors as IRS' basic mission of fairly and equitably administering the tax laws and collecting taxes due the government, the level of resources now available to IRS to accomplish that mission, the extent of noncompliance with the tax laws, and the growing taxpayer population.

--Second, we believe that the amounts specifically requested for the returns processing and collection activities may be insufficient to cope with their workloads. The budget request for 1987 assumes that IRS' service centers will have fully recovered from the problems they experienced last year in maintaining manageable inventory levels. The evidence available at the time we prepared this statement, however, calls IRS' assumption into question. As for collections, neither the 1986 supplemental nor the 1987 budget request provides additional resources to deal with an accounts receivable inventory that, according to IRS' records, rose dramatically in 1985.

--Third, the Congress is presently forced to make resource decisions on an activity by activity basis because IRS' management information system does not provide the kind of marginal yield data needed to determine where

additional resources would best be allocated or whether existing allocations provide for the best use of IRS' resources. Because of that limitation in IRS' data, we cannot tell you where additional resources should be applied in IRS to yield the best results. For example, accounts receivable is not the only inventory in IRS that needs attention. There are various service center inventories, as mentioned earlier, and inventories in appeals and tax litigation that are expected to continue to rise even after applying the additional resources called for in the 1987 budget request.

--Fourth, mindful of the limitations in IRS' data, we recognize, nonetheless, that the Congress needs to make budget decisions based on the best information available. With that in mind, we believe additional returns processing resources would be justified to the extent they help foster improved taxpayer relations through a reduction in inventories of taxpayer correspondence, unpostable transactions, and the like. We believe, also, that IRS' reported average yield/cost ratio of about 19 to 1 in the accounts receivable area and the significant growth in the accounts receivable inventory indicate that additional collection resources would provide a favorable return on the dollar.

Before going into more detail on the proposed budget for 1987 and its impact on specific IRS activities, a short preface

about noncompliance and other factors that affect IRS' workload might prove useful.

NONCOMPLIANCE

As shown in attachment I to my statement, our tax system provides about 90 percent of the revenues for financing the government's programs and activities. As such, the federal government's financial well-being depends, in large measure, on whether people are willing and able to comply with the tax laws.

IRS research, however, points to a significant level of noncompliance with those laws. IRS has estimated, for example, that the noncompliance rate in 1981 was 19.3 percent and that the tax gap--taxes owed but not paid--was \$81.5 billion (see attachment II). For fiscal year 1987, IRS has projected a noncompliance rate of 18.15 percent and a tax gap of \$100.5 billion.

A detailed survey conducted in 1984 by Yankelovich, Skelly and White, Inc., attempted to determine why people do not comply. The study showed that almost 20 percent of the sampled population admitted to cheating in preparing their federal income tax returns and that about 33 percent strongly endorsed cheating. The study also found that personal definitions of honesty and the perception that most people cheat were the most significant reasons why people did not comply.

FACTORS AFFECTING IRS' WORKLOAD

Any assessment of IRS' budget has to take into account the workload facing IRS and the fact that IRS' workload has been growing steadily over the years (see attachment III). I will be citing various workload statistics later in my statement as they relate to specific IRS functions. There are two factors, however, that affect IRS' workload across-the-board but over which IRS has little, if any, control. Those factors are (1) a continuing growth in the size of the taxpaying public as evidenced by the increase in filed tax returns and (2) tax law complexity.

The number of tax returns filed has increased

Over the past several years, IRS has had to process a steadily growing number of tax returns without an appropriate increase in resources. For example, IRS statistics indicate that taxpayers filed about 170 million tax returns in 1985--a 38-percent increase since 1976, when taxpayers filed 123 million returns. At the same time, IRS' staff years increased from 84,300 in fiscal year 1976 to 92,259 in fiscal year 1985--an increase of about 9 percent. Although IRS has attempted to improve productivity through such things as an increased use of computers, those steps have not been sufficient to enable IRS to effectively cope with its increased workload given the staff available.

Tax law complexity

Frequent changes to the Internal Revenue Code have produced tax provisions that are increasingly difficult for taxpayers to understand and IRS to administer. Such changes often make examinations more difficult; generate more controversies between IRS and taxpayers; and require IRS to revise or extend its guidance to taxpayers through regulations, publications, and tax forms. For example, the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 and the Deficit Reduction Act of 1984 have resulted in the need to amend or create 250 regulations.

The impact of complexity can also be seen in the fact that a growing number of individual taxpayers are filing the long form 1040 despite efforts to create a simpler tax form, the 1040EZ, and to make the shorter 1040A usable by more taxpayers. IRS estimates that 64 percent of the individual taxpayers will file a Form 1040 in 1986--up from 60 percent in 1982. Moreover, IRS estimates that the number of 1040As and 1040EZs filed this year will decrease by 9 percent and 3 percent, respectively, from the number filed last year. Increasing use of the long form adversely affects IRS' workload because these forms take longer to process and audit.

IMPACT OF BUDGET REQUEST
ON MAJOR IRS ACTIVITIES

As shown in attachment IV to my statement, the 1986 supplemental appropriation and the budget request for 1987, when considered together, provide for substantial increases in IRS' examination, returns processing, taxpayer service, and appeals/tax litigation activities. We believe each of those increases is warranted. We believe also, however, that the staffing level requested for returns processing in fiscal year 1987 may be insufficient considering the current status of service center inventory levels.

The 1986 supplemental and 1987 budget request provide for virtually no change in staffing levels in IRS' collection function. Considering the status of IRS' inventory of accounts receivable, it seems reasonable to assume that the infusion of additional resources into the collection function would prove beneficial. Because of limitations in IRS' management information, however, we do not know whether additional resources, if available to IRS, would provide even greater benefits if applied to some function other than collections.

Examination activities

Examination is IRS' primary program for determining whether taxpayers have correctly determined their tax liabilities. To do this, IRS examines taxpayers' books and records to verify reported income and deductions, uncover unreported income, and

validate exemptions and credits. In fiscal year 1985, IRS examinations resulted in assessments of \$17.7 billion.

The fiscal year 1987 budget request for examination provides for a net increase of 2,562 average positions. This increase reflects the Administration's decision to support two specific enforcement initiatives affecting IRS' examination activity--a revenue initiative and a document matching initiative. This increase is significant in that, if approved, IRS estimates that audit coverage will go up slightly--reversing a downward trend over the past 10 years. In addition, the increase should improve IRS' ability to deal with special compliance problems, such as those posed by abusive tax shelters and tax havens.

The revenue initiative calls for an increase of 2,500 average positions in each of the next 3 years, beginning in fiscal year 1987. According to IRS budget estimates, this initiative is expected to increase collected revenue by \$4.7 billion through fiscal year 1989 and \$10.3 billion through fiscal year 1991. For fiscal year 1987, IRS estimates that as a result of this initiative, it will examine an additional 120,000 tax returns, which will result in assessments of \$829 million. As we have testified on other occasions, we believe this initiative would be money well spent because it would increase revenues due the government and increase IRS' examination presence.

For the document matching initiative, the Administration proposes an increase of 135 average positions in Examination to follow up on underreported income cases generated by the document matching program. IRS' budget estimates indicate that these additional positions will enable IRS to increase assessments by \$37 million in fiscal year 1987, raising the total number of assessments generated by the underreporter program to \$404 million.

If the 1987 budget request is approved, IRS expects to reverse the downward trend in audit coverage. IRS estimates that audit coverage will increase to 1.42 percent in 1987--up from 1.14 percent in 1986 but still significantly lower than it has been in the past. To provide some perspective, audit coverage was 2.59 percent in 1976 and 2.12 percent in 1980.

Although audit coverage has decreased since 1976, there is at least one significant difference between IRS' enforcement program in 1976 and its program today. IRS' document matching program in 1976 was not nearly as large as it is now. In fiscal year 1976, IRS was able to match about 157 million documents, or 35 percent of all documents received. In fiscal year 1985, by comparison, IRS was able to match about 541 million documents, or 78 percent of all documents received. Moreover, new tax laws, such as TEFRA, have expanded information and reporting requirements, as is the case with tips in the food and beverage industry. Because IRS' document matching program can identify potential underreporter cases that lead to eventual assessments,

it could be argued that document matching plays a major role in insuring compliance and offsets the adverse effect of decreasing audit coverage. In our view, however, nothing completely takes the place of increased audit coverage. Certain deductions, such as those for travel and entertainment expenses, can only be verified through an audit.

Returns processing activities

This is another area where the Administration is requesting a substantial increase in resources. In response to the returns processing problems IRS encountered last year, the supplemental appropriation request for 1986 proposes an additional 5,558 average positions so that tax returns and refunds can be processed in a timely manner. Specifically, IRS plans to use the additional resources to (1) restore production rates to those achieved in fiscal year 1984; (2) compensate for the decline in retention of experienced seasonal employees; (3) clear up backlogs in unpostables, adjustments, and taxpayer correspondence; and (4) improve the quality of operations. Considering last year's problems and the need to avoid a recurrence, we believe that the additional resources are warranted.

The 1986 supplemental also provides for an additional 255 average positions to process an expected increase in the volume of currency and cash transaction reports. These documents are used by various law enforcement agencies and are a key element

in combatting organized crime and drug trafficking. The influx of these reports is the direct result of the Treasury Department's increased enforcement of Bank Secrecy Act provisions.

IRS' fiscal year 1987 budget request calls for a reduction of 1,590 average positions in the returns processing area. This decrease is the net result of (1) increases of about 1,100 average positions to staff the document matching initiative and to process additional tax returns and (2) a decrease of about 2,700 average positions that IRS considers nonrecurring costs. Those 2,700 positions are part of the increase proposed in the 1986 supplemental and are intended, for the most part, to reduce service center inventories to manageable levels. Because IRS expected to have those inventories at manageable levels by the start of fiscal year 1987, it did not include those resources in the 1987 budget. However, if IRS fails to bring its inventories under control by the end of this fiscal year, that decrease in staffing could prove damaging. IRS' statistics show that only three service centers had their unpostable inventories at manageable levels as of April 25, 1986, and only one service center had its adjustments/correspondence inventory at a manageable level.

Given the current status of those inventories, we question whether they will be at manageable levels by the end of this fiscal year. IRS' service centers have provided information to the National Office to the effect that existing resources are

insufficient. The National Office has been reassessing the adequacy of its returns processing resources in light of that feedback. It remains to be seen whether that reassessment will cause IRS to propose a revision to its 1987 budget request.

For the document matching initiative as it relates to returns processing, IRS proposes an increase of 660 average positions in fiscal year 1987. At that level of resources, IRS expects to generate an additional 1.25 million contacts in fiscal year 1987 resulting in increased assessments of \$229 million.

Taxpayer service activities

Because our income tax laws are complex and not always clear, taxpayers often turn to IRS for help in preparing their tax returns. IRS provides much of that help through forms, instructions, and publications. In addition to making such documents available to taxpayers, IRS also answers tax law questions over the telephone, at walk-in offices, and through correspondence. During fiscal year 1985, according to IRS' statistics, IRS assisted taxpayers about 42 million times--an increase of 22 percent since 1980. Total taxpayer assistance activity also increased 17 percent--from 43 million contacts in 1980 to 50.3 million contacts in 1985.

In light of the problems it faced last year, IRS recognized the need to be as responsive to taxpayers as possible this year in order to assuage public concerns about our tax system. Its

supplemental appropriation request for fiscal year 1986 calls for an increase of 670 average positions in the taxpayer service area and provides funds for the installation of 336 toll-free telephone circuits, an increase of about 11 percent. The budget request for 1987 calls for reducing that increased staffing level by 24 positions.

We have little doubt that those increased resources are necessary. Neither we nor IRS know, however, whether that will be enough. At the request of this Subcommittee, we have been checking on the accuracy and timeliness of IRS' telephone assistants in answering tax-related questions during the 1986 filing season. We are now analyzing the results of that work. That analysis should be useful in determining whether IRS' resources are now adequate to provide a sufficient level of service. Also, IRS plans, in mid-May, to reassess the adequacy of its taxpayer service staffing levels.

Appeals and tax litigation activities

The appeals and tax litigation activities are primarily responsible for handling cases involving taxpayers who disagree with IRS' examination results. The fiscal year 1987 budget request calls for an additional 497 average positions in those activities, an increase of 14 percent compared to the staffing level authorized for 1986. Of those positions, 465 are allocated to fund a tax shelter initiative. The purpose of this initiative is to provide resources to help appeals and tax

litigation deal with the large number of tax shelter cases in their inventories and the additional cases they can expect to receive as a result of ongoing audits involving tax shelter issues. According to IRS' statistics, there were 412,278 returns with tax shelter issues in the examination process as of December 1985--137 percent more than the fiscal year 1980 inventory of about 174,000.

Under this initiative, IRS expects to close an additional 15,000 appeals and resolve over 11,000 additional cases in tax litigation. According to IRS, these closings should accelerate the collection of tax revenues by \$600 million in fiscal year 1987. Also, resolving a certain portion of these cases within IRS could lighten the Tax Court's workload. As of February 1986, the Tax Court had an inventory of 72,892 cases of which about 30,000 involved tax shelter issues.

IRS' budget estimates indicate that even with this tax shelter initiative, ending inventories in appeals and tax litigation are expected to rise dramatically. For example, the fiscal year 1987 ending inventory in appeals is expected to rise to 120,200 work units, an increase of 53,700 (or 81 percent) since 1985. Likewise, the ending inventory in tax litigation is expected to increase by 53 percent--from 82,200 in 1985 to 125,900 in 1987. Because much of the appeals/tax litigation workload involves taxpayers who are contesting IRS' audit findings, it seems reasonable to expect further increases in that workload as a result of the additional audits that will be

generated if IRS' revenue initiative is approved. In light of that, it would not be unreasonable to expect IRS to seek additional appeals and tax litigation resources in its budget requests for fiscal year 1988 and beyond.

Collection activities

Although IRS has made significant progress in automating its collection operation, it has not been able to keep up with the overall collections workload. According to IRS' statistics, the Service collected \$743 billion in fiscal year 1985--an increase of 9 percent over the previous year--while the overall collections workload, as measured by accounts receivable, has grown dramatically during the past year. As shown in attachment V, IRS' accounts receivable, which are taxes owed but not collected, grew from \$34.4 billion in December 1984 to \$45 billion in December 1985--an increase of 31 percent.

This increase in accounts receivable is especially dramatic when compared to the overall growth of the tax system and to the historical growth in accounts receivable. During fiscal year 1985, for example, accounts receivable grew by 44 percent (see attachment VI) while IRS' net tax receipts grew by about 9 percent--that is, accounts receivable grew almost four times as much as net revenues. In comparison, the growth in accounts receivable during fiscal year 1984 was much smaller (about 15 percent) and much more comparable to the 10 percent growth in tax receipts.

We asked IRS to explain the dramatic growth in accounts receivable. IRS pointed to the following three reasons:

--The number of tax returns filed had increased by about 7 million, or 4 percent, from fiscal year 1983 to fiscal year 1985.

--The amounts owed on tax returns filed had increased from \$40.8 billion in December 1984 to \$59.6 billion in December 1985, an increase of 46 percent.

--The backlog of unposted payments and account adjustments left over from last year's filing season accounted for several billion dollars in accounts receivable.

Notwithstanding the dramatic increase in accounts receivable, neither the 1986 supplemental nor the 1987 budget request provides for additional revenue officers. IRS officials explained that they were not aware of the dramatic growth in accounts receivable at the time they were preparing those budget documents.

Although it is reasonable to assume that additional collection resources would produce benefits in excess of costs, we are not in a position to suggest that collection would be the best place to apply additional resources if they were to become available. Our hesitancy is caused by limitations in IRS' management information system, which I will discuss next.

IMPROVEMENTS NEEDED IN
ALLOCATING IRS' RESOURCES

It is not too difficult to argue that IRS needs additional resources and that the increases called for in the supplemental appropriation request and the budget request for fiscal year 1987 are justified and will produce additional revenues. It is not as easy, however, to justify an increase in resources for one activity versus another--especially in the enforcement area--or to comment on whether the 1986 supplemental and the 1987 budget request, as allocated, provide for the most effective overall use of IRS resources. For example, is it best to increase examination staff by 2,652 average positions while maintaining the status quo in collections (as is proposed in the fiscal year 1987 budget request) or is some other mix better?

IRS' management information system has not provided the kind of reliable data needed to determine the overall effectiveness of its compliance programs and to help it decide how best to allocate resources among various activities. To do that, IRS needs accurate data on the cost and marginal yield associated with each of its compliance programs. Generally, however, it has data showing only "average" dollar yields (see attachment VII). IRS' examination model allows measurements of yield "at the margin" for the examination program, but similar measurements have not been available for other compliance programs. In June 1986, however, IRS plans to implement an Enforcement Resource Allocation Model which is designed to

measure marginal yield for the examination, information returns, and delinquent returns programs. We have not assessed that model to determine if it will provide the kind of reliable information needed to effectively allocate compliance resources.

BUDGET REQUEST FOR ADP
AND INFORMATION TECHNOLOGY

The ADP and Information Technology part of the budget calls for \$634.2 million for fiscal year 1987. While not the largest item in the budget, it is extremely important because IRS relies so heavily upon ADP to meet its mission. Given the fact that IRS has recently made some changes in key ADP initiatives and is considering others, and given the Subcommittee's active interest in oversight, we believe that the Subcommittee could enhance its oversight activities by asking IRS to provide more information on its ADP goals and the short- and long-term budget implications of those goals. Our specific reasons for coming to this conclusion are as follows.

First, over the last few years the Congress has provided several hundred million dollars to fund ADP initiatives at IRS. These initiatives have included:

- The Service Center Replacement System to replace old computers and software which support tax returns processing.
- The Automated Examination System to introduce automation to the examination function.

--The Automated Collection System to employ automation in making telephone contact with delinquent taxpayers.

--The Integrated Data Retrieval System to bring more advanced technology to the on line system that allows access to taxpayer account information.

Second, the \$634.2 million in the 1987 budget is for a combination of new projects, maintenance of existing projects, and staffing. Among the largest dollar items are \$124.1 million for telecommunications, \$73.2 million for the Automated Collection System and \$51.3 million for the Automated Examination System. In addition, \$32.5 million is budgeted for terminals, front-end processors, and other support costs to fund the Integrated Data Retrieval System. For this latter project IRS originally awarded a contract to Computer Systems and Resources, Inc. The GSA Board of Contract Appeals overturned that award and IRS subsequently awarded the contract to SYSOREX for a systems life cycle cost of just over \$156 million, or \$59 million more than the original award. We understand that, due to the timing of the Board of Contract Appeals' decision and the subsequent reaward, the portion of the additional cost needed for fiscal year 1987 is not included in the fiscal year 1987 budget request.

Third, IRS' ADP and Information Technology budget plans over the next few years call for several billion dollars to continue its ongoing and planned short- and long-term ADP initiatives. The long-term initiative includes bringing on line

IRS' Tax System Redesign (TSR). IRS intends TSR to provide the modern technology needed to bring IRS into the 21st century and anticipates that the system, when fully implemented, will represent a life cycle cost of billions of dollars.

However, beginning with the extensive computer problems encountered in the 1985 filing season, IRS has made a number of major changes to its ADP plans and is considering other changes. For example,

- an unanticipated multi-million dollar procurement was initiated to significantly expand the Sperry systems at IRS service centers;
- another multi-million dollar project to improve the data input and initial processing of tax returns was recently scrubbed--no funds for this project are included in the fiscal year 1987 budget request;
- another multi-million dollar procurement to replace the Sperry systems is being reevaluated; funding for this project is presently planned to commence in fiscal year 1988; and
- the TSR effort is being reevaluated.

In view of (1) the changes IRS is considering in its overall game plan, (2) the millions of dollars already spent and authorized, and (3) the number of dollars to be requested in the future, the Subcommittee may want to consider asking IRS to provide a brief overview of its strategic plan--a road map, if

you will--which clearly and concisely spells out how its current ADP initiatives relate to one another and how it expects to move from these initiatives to TSR. Anticipated budget requirements should also be spelled out.

POTENTIAL IMPACT OF THE
GRAMM-RUDMAN-HOLLINGS ACT

Gramm-Rudman-Hollings requires that the deficit for fiscal year 1987 not exceed \$144 billion. Obviously, it is too early to determine whether sequestration will be necessary. That depends on whether the Congress and the Administration can agree on a budget that meets the act's requirements and could depend on the results of legal actions now pending before the Supreme Court. These factors aside, should a sequestering of funds become necessary for fiscal year 1987, key functions in IRS could suffer. Just how much depends on the percentage that would have to be cut from each IRS program or activity.

As shown in attachment VIII, 68 percent of IRS' fiscal year 1987 budget is devoted to funding staff-related resources. For example, IRS' 1987 budget estimates show that staff resources comprise 80 percent of the Examination and Appeals account and 72 percent of the Investigations, Collections, and Taxpayer Service account (see attachments IX and X). A sequestration sufficiently large to reach IRS' staff-related resources could have a pronounced negative effect on IRS' operations.

Regarding potential impact, a cut in staff resources in the returns processing area could result in delays in the processing of tax returns and, in turn, delays in issuing refunds to taxpayers. Such a situation could cause an increase in government interest payments if refunds are not processed in a timely manner. In the Examination and Collections Divisions, a reduction in staff would probably result in fewer dollars assessed and collected.

CONCLUSIONS

In conclusion, we believe that approval of the supplemental appropriation request for 1986 and the fiscal year 1987 budget requested by the Administration is vital to prevent further erosion of the tax system. We believe also that additional returns processing and collection resources may be warranted, even considering limitations in IRS' management information system.

It is particularly important, Mr. Chairman, that the Congress act immediately on the supplemental request for 1986. In attempting to avoid a recurrence of the processing problems it encountered last year and thus improve public confidence in the tax system, IRS has already increased its returns processing and taxpayer assistance staff levels as provided for in the supplemental request. According to the Secretary of the Treasury, if the supplemental is not approved, IRS will be forced to furlough employees in September and take other

measures that will lead, in total, to an estimated revenue loss of about \$3.5 billion in fiscal years 1986 and 1987.

In closing, let me mention three points that we believe the Congress should keep in mind in deliberating on the desirability of providing IRS with more resources.

First, because workloads in various IRS activities are interrelated, funding IRS' examination initiatives for fiscal year 1987--primarily the revenue initiative--will probably have a ripple effect on other IRS functions, such as collections and appeals. That ripple effect will cause workloads in other areas to increase, which will probably generate IRS requests for additional resources in fiscal year 1988 and beyond.

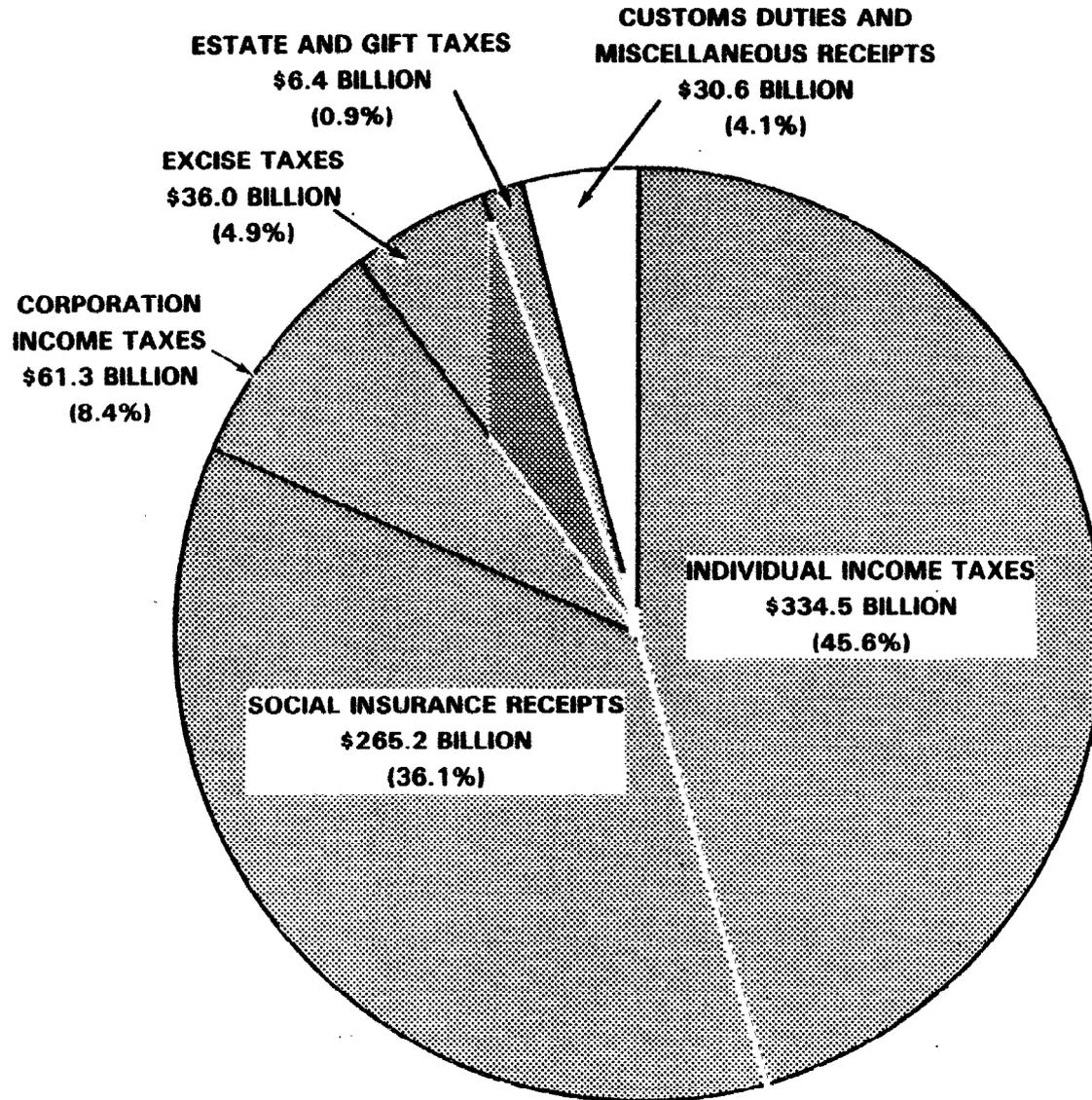
Second, IRS' unique role should be recognized. IRS stands virtually alone on the "revenue side" of the government. Government-wide reductions applied to IRS will likely result in foregone revenues, thus increasing the deficit. Providing IRS with additional resources will have the opposite effect. While the tax system collected about \$743 billion in revenue in fiscal year 1985, IRS' budget for 1985 was \$3.6 billion. Thus, IRS' administration of our tax system cost about 48 cents for each \$100 collected.

Third, it is important to keep in mind that IRS' various activities do no more than require citizens to pay those taxes that were properly due in the first place, and that were promptly paid by most of their number. Effective compliance should not be viewed as representing a special burden on the

public; rather, it is aimed at ensuring that all pay their fair share.

That concludes my prepared statement. I will be pleased to answer any questions.

FEDERAL REVENUES
FISCAL YEAR 1985 ACTUAL

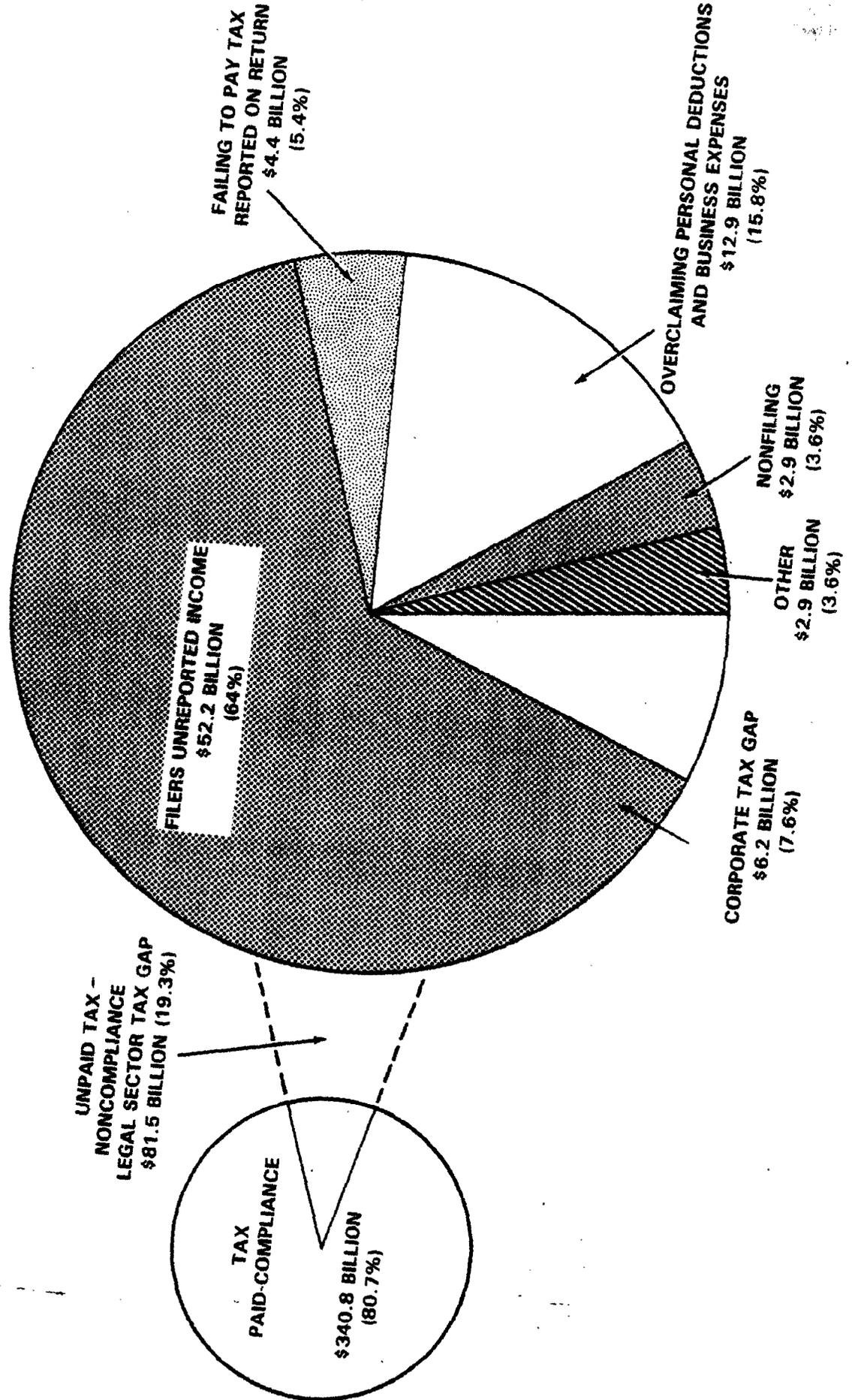


Source: Office of Management and Budget

 SHADED PORTION INDICATES COLLECTIONS MADE BY IRS

NOTE: THIS CHART SHOWS RECEIPTS ONLY. IT DOES NOT SHOW THAT PORTION OF THE BUDGET FINANCED THROUGH BORROWING. ALSO, A SMALL PORTION OF THE EXCISE TAX COLLECTIONS IS THE RESPONSIBILITY OF THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS, DEPARTMENT OF THE TREASURY.

ESTIMATED LEGAL SECTOR TAX GAP IN 1981



SOURCE: IRS

**IRS Resources and Workload by Program
Fiscal Years 1976, 1985, 1987**

| Program | FY1976 | | FY1985 | | FY1987 | | Change 1976-87 | |
|---------------------------------|-------------------|-------------------------|-------------------|-------------|-------------------|-------------|-----------------------|------------------------|
| | Workload (000) | Staff Years (Note a) | Workload (000) | Staff Years | Workload (000) | Staff Years | Workload (Percent) | Staff Years Percent |
| Examination (Note b) | 89,200 | 28,164 | 103,329 | 29,009 | 112,373 | 32,484 | 26.0 | 15.3 |
| Collection Delinquent Accounts | 3,441 | 8,617 | 4,405 | 14,042 | 3,517 | 12,464 | 2.2 | 44.6 |
| Delinquent Returns | 1,115 | 1,693 | 2,526 | 3,898 | 2,644 | 3,499 | 137.1 | 106.7 |
| Returns Compliance (Note c) | 248 | 405 | 7 | 192 | 10 | 105 | -96.0 | -74.1 |
| Criminal Investigation (Note d) | 8.1 | 4,090 | 6.1 | 4,686 | 6.0 | 4,408 | -25.9 | 7.8 |
| Information Returns (Note e) | 471,579 | 1,700 | 783,000 | 4,467 | 931,000 | 5,767 | 97.4 | 239.2 |
| Returns Processing | 123,101 | 26,436 | 170,021 | 24,449 | 178,622 | 25,844 | 45.1 | -2.2 |
| Taxpayer Service (Note f) | 38,600 | 4,582 | 50,208 | 4,584 | 45,657 | 4,860 | 18.3 | 6.1 |
| Total IRS Staff Years | | 84,264 | | 92,259 | | 95,084 | | 12.8 |
| Total IRS Appropriation | | \$1,691,520 | | \$3,574,597 | | \$4,097,792 | | 142.3 |
| | | (000) | | (000) | | (000) | | |

(a) 1976 staff years are not adjusted to reflect organizational shifts.

(b) Examination workload is prior calendar year income, estate, gift and partnership returns filed.

(c) Returns compliance workload is number of delinquent returns secured.

(d) Criminal Investigation workload is number of investigations initiated during the fiscal year.

(e) Information returns is a multifunctional program and some of the staff years shown for that program are also included in the staff years for other programs listed above.

(f) Taxpayer Service workload is taxpayers assisted.

(g) Estimate

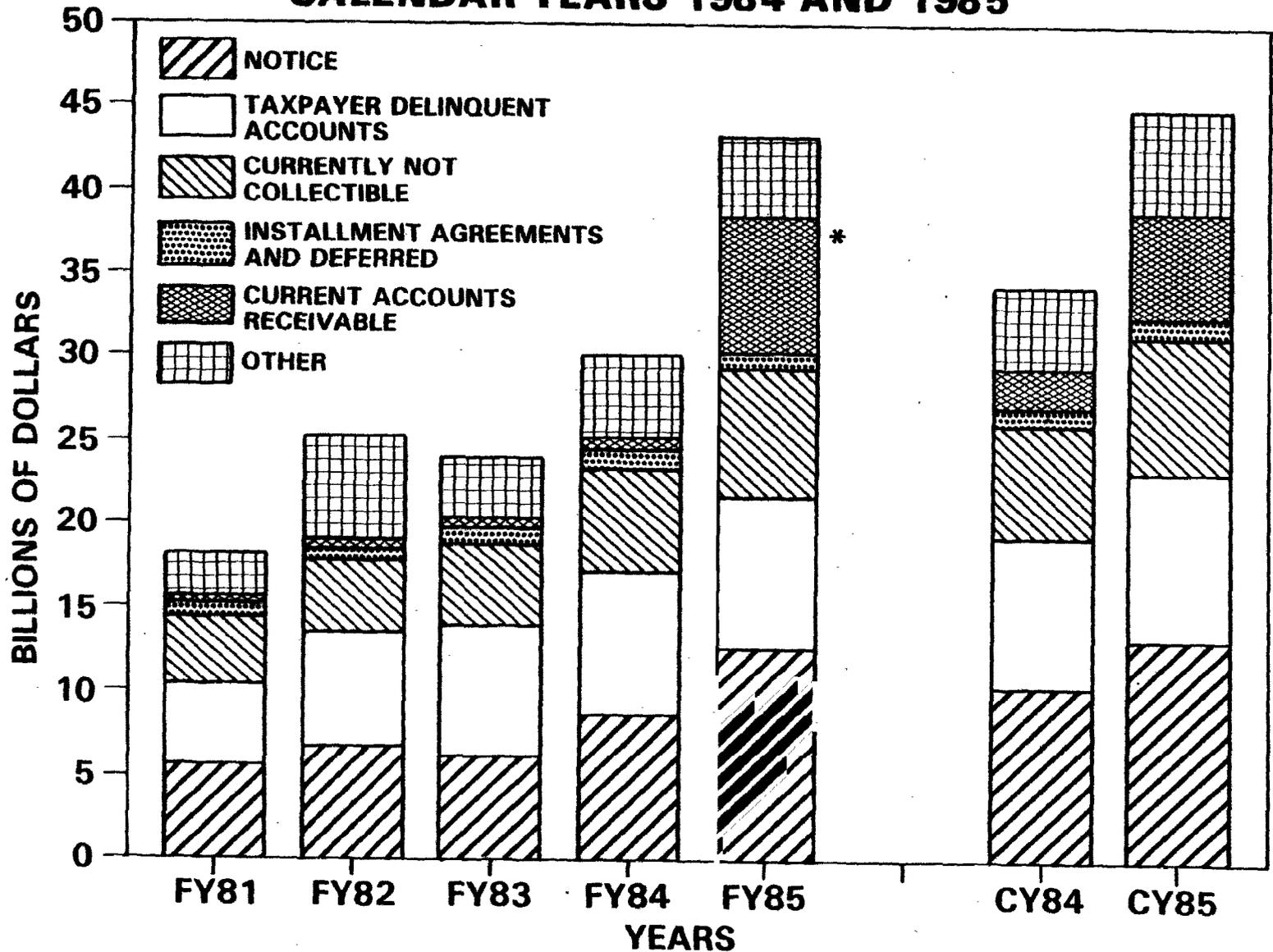
SOURCE: IRS

**Comparison of IRS' Fiscal Year 1986 Continuing Resolution, Revised Fiscal Year 1986 Budget, and
Fiscal Year 1987 Proposed Budget
Summary of Staffing**

| IRS Program | FY86 C.R. | FY86 Rev. | FY87 | Change from C.R. to FY87 | | Change from Rev.86 to FY87 | |
|---|-----------|-----------|--------|-----------------------------|---------|-------------------------------|---------|
| | | | | Amount | Percent | Amount | Percent |
| Executive Direction | 127 | 127 | 122 | (5) | -3.94 | (5) | -3.94 |
| Management Services | 1,944 | 1,944 | 1,922 | (22) | -1.13 | (22) | -1.13 |
| Sub-total | 2,071 | 2,071 | 2,044 | (27) | -1.30 | (27) | -1.30 |
| Returns Processing and Revenue Accounting | 21,621 | 27,434 | 25,844 | 4,223 | 19.53 | (1,590) | -5.80 |
| Computer Services | 1,510 | 1,510 | 1,483 | (27) | -1.79 | (27) | -1.79 |
| Sub-total | 23,131 | 28,944 | 27,327 | 4,196 | 18.14 | (1,617) | -5.59 |
| Examination | 29,518 | 29,922 | 32,484 | 2,966 | 10.05 | 2,562 | 8.56 |
| Appeals and Tax Litigation | 3,537 | 3,600 | 4,097 | 560 | 15.83 | 497 | 13.81 |
| Employee Plans and Exempt Organizations | 2,401 | 2,401 | 2,393 | (8) | -0.33 | (8) | -0.33 |
| Sub-total | 35,456 | 35,923 | 38,974 | 3,518 | 9.92 | 3,051 | 8.49 |
| Tax Fraud Investigations | 4,413 | 4,413 | 4,408 | (5) | -0.11 | (5) | -0.11 |
| Collection | 16,056 | 16,056 | 16,068 | 12 | 0.07 | 12 | 0.07 |
| Taxpayer Service | 4,214 | 4,884 | 4,860 | 646 | 15.33 | (24) | -0.49 |
| Enforcement Litigation and Rulings | 1,433 | 1,433 | 1,403 | (30) | -2.09 | (30) | -2.09 |
| Sub-total | 26,116 | 26,786 | 26,739 | 623 | 2.39 | (47) | -0.18 |
| Total | 86,774 | 93,724 | 95,084 | 8,310 | 9.58 | 1,360 | 1.45 |

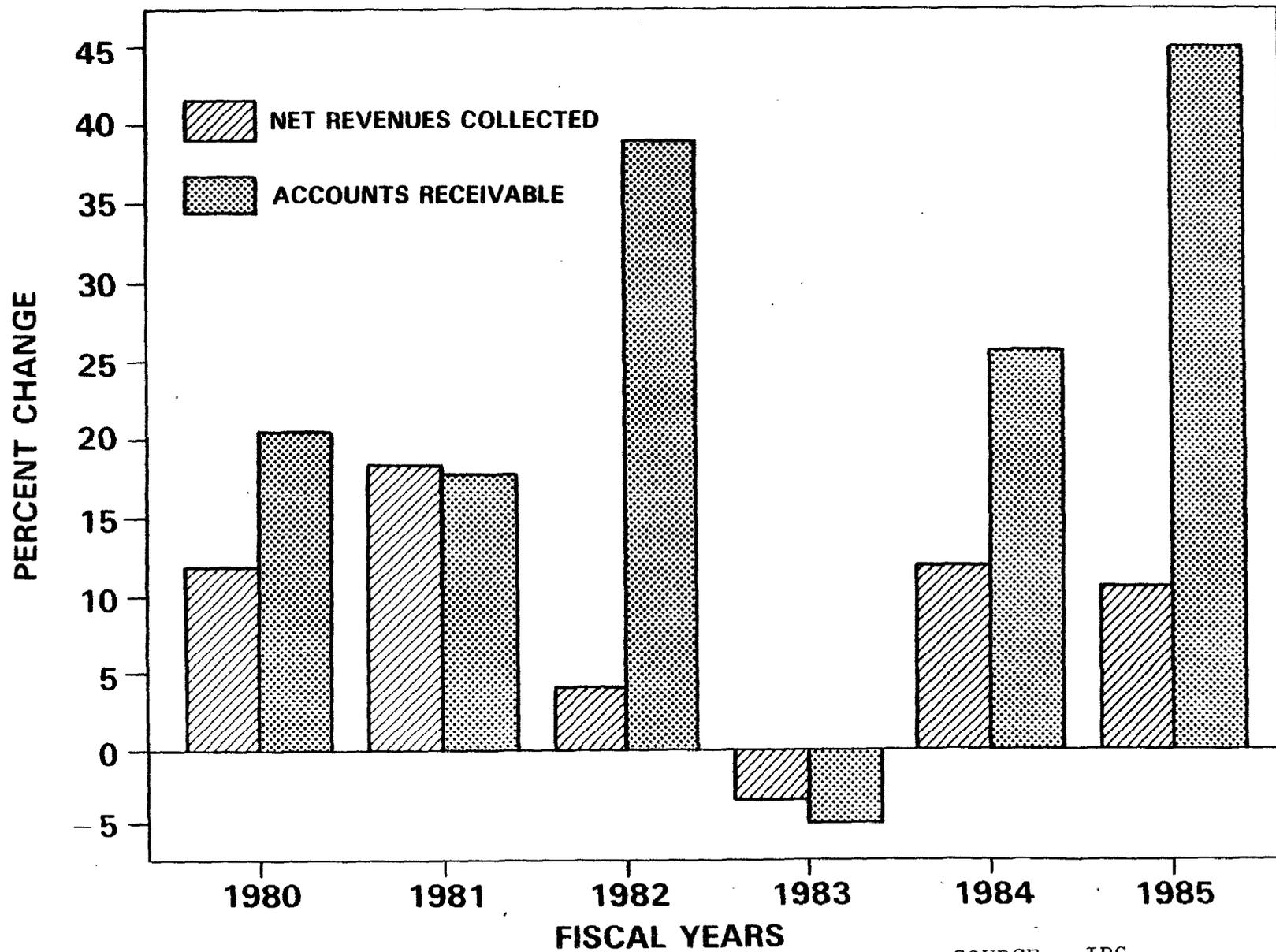
SOURCE: IRS

STATUS OF ACCOUNTS RECEIVABLE AT END OF FISCAL YEARS 1981-1985 AND END OF CALENDAR YEARS 1984 AND 1985



* AN ACCOUNTING CHANGE WAS MADE IN FISCAL YEAR 85 THAT RECLASSIFIED BALANCE DUE NOTICES UNDER 30 DAYS FROM DELINQUENT TO CURRENT STATUS.

PERCENT CHANGES IN ACCOUNTS RECEIVABLE AND COLLECTIONS



SOURCE: IRS

**Yield/Average Cost Estimates¹ for Selected IRS Programs
Fiscal Years 1984 through 1987
(Dollars in Millions)**

| | <u>FY 1984</u> | <u>FY 1985</u> | <u>FY 1986³</u> | <u>FY 1987³</u> |
|-----------------------------------|----------------|----------------|----------------------------|----------------------------|
| Examination | | | | |
| Yield | \$10,428 | \$12,615 | \$10,433 | \$11,296 |
| Cost | \$997.3 | \$1,081.5 | \$1,130.1 | \$1,266.4 |
| Ratio | 10.46 | 11.66 | 9.23 | 8.92 |
| Criminal Investigations | | | | |
| Investigations | 6,194 | 6,065 | 5,962 | 6,027 |
| Cost | \$204.1 | \$220.0 | \$210.8 | \$223.8 |
| Cost/Inv. ² | \$32,951 | \$36,274 | \$35,357 | \$37,133 |
| Accounts Receivable | | | | |
| Yield | \$8,928 | \$9,062 | \$8,684 | \$8,889 |
| Cost | \$459.2 | \$473.3 | \$488.4 | \$508.5 |
| Ratio | 19.44 | 19.15 | 17.78 | 17.48 |
| Delinquency Investigations | | | | |
| Yield ⁴ | \$5,660 | \$5,663 | \$5,299 | \$5,449 |
| Cost | \$109.0 | \$103.2 | \$86.5 | \$92.5 |
| Ratio | 51.93 | 54.87 | 61.26 | 58.91 |
| Returns Compliance | | | | |
| Yield | \$17 | \$10 | \$12 | \$15 |
| Cost | \$4.4 | \$6.6 | \$3.5 | \$3.8 |
| Ratio | 3.86 | 1.52 | 3.43 | 3.95 |
| Document Matching | | | | |
| Yield | \$1,562 | \$2,352 | \$2,711 | \$3,014 |
| Cost | \$116.4 | \$135.1 | \$154.0 | \$186.7 |
| Ratio | 13.42 | 17.41 | 17.60 | 16.14 |

¹Yield is shown in millions of dollars of net assessments except for the Criminal Investigations Program and the Accounts Receivable Program. The Criminal Investigation Program is measured in total investigations; the Accounts Receivable Program in collections after the first notice.

²Cost per investigation is total dollar cost.

³Estimated

⁴Assessments shown for Delinquency Investigations are before any offsets for refunds; additionally, the amount ultimately collected would be less.

Source: IRS

**Comparison of IRS' Personnel and Non-Personnel Resources
Fiscal Year 1984, 1985 and 1987 Appropriations**

| Standard Object Classification | Summary | | Summary | | Summary | |
|---|--|---------------|--|---------------|--|---------------|
| | 1984 Appropriation (\$ In Thousands) | Percent | 1985 Appropriation (\$ In Thousands) | Percent | 1987 Appropriation (\$ In Thousands) | Percent |
| Personnel Costs | | | | | | |
| Permanent Positions | 1,839,633 | 55.32 | 1,978,661 | 55.35 | 2,030,777 | 49.56 |
| Temporary Positions | 206,743 | 6.22 | 244,358 | 6.84 | 215,106 | 5.25 |
| Other Personnel Compensation | 62,827 | 1.89 | 71,342 | 2.00 | 58,193 | 1.42 |
| Special Personal Service Payments | 11,323 | 0.34 | 5,393 | 0.15 | 9,522 | 0.23 |
| Personnel Benefits | 267,498 | 8.04 | 302,470 | 8.46 | 346,793 | 8.46 |
| Benefits for Former Personnel | 16,158 | 0.49 | 17,357 | 0.49 | 18,930 | 0.46 |
| Travel and Transportation of Persons | 99,995 | 3.01 | 91,951 | 2.57 | 121,337 | 2.96 |
| Total Personnel Costs | 2,504,177 | 75.30 | 2,711,532 | 75.86 | 2,800,658 | 68.35 |
| Non-Personnel Costs | | | | | | |
| Transportation of Things | 27,540 | 0.83 | 29,054 | 0.81 | 27,625 | 0.67 |
| Standard Level User Charges | 187,737 | 5.65 | 225,933 | 6.32 | 272,256 | 6.64 |
| Rental Payments to Others | | 0.00 | 477 | 0.01 | 687 | 0.02 |
| Other Rent, Communications, Util. | 229,405 | 6.90 | 264,011 | 7.39 | 397,104 | 9.69 |
| Printing-Reproduction | 68,642 | 2.06 | 79,638 | 2.23 | 94,461 | 2.31 |
| Other Services | 136,672 | 4.11 | 174,114 | 4.87 | 222,914 | 5.44 |
| Supplies and Materials | 36,770 | 1.11 | 36,340 | 1.02 | 53,117 | 1.30 |
| Equipment | 86,171 | 2.59 | 77,496 | 2.17 | 69,593 | 1.70 |
| Grants, Subsidies, and Contribu. | 1,703 | 0.05 | 1,936 | 0.05 | 2,200 | 0.05 |
| Insurance Claims and Indemnities | 250 | 0.01 | 422 | 0.01 | 538 | 0.01 |
| Total Non-Personnel Costs | 774,890 | 23.30 | 889,421 | 24.88 | 1,140,495 | 27.83 |
| Undistributed | | | | | | |
| Unobligated Balance | 6,299 | 0.19 | 2,647 | 0.07 | 156,639 | 3.82 |
| Unobligated Balance Available Start of Year | (24,068) | -0.72 | (64,332) | -1.80 | | |
| Unobligated Balance Available End of Year | 64,332 | 1.93 | 35,329 | 0.99 | | |
| Total Appropriation | 3,325,630 | 100.00 | 3,574,597 | 100.00 | 4,097,792 | 100.00 |

SOURCE: IRS

**Analysis of IRS' Fiscal Year 1987 Budget Request of
Personnel and Non-personnel Funding Levels**

| Standard Object Classification | Examination & Appeals | | Investigation, Collection, and Taxpayer Service | | Processing Tax Returns | | Salaries & Expenses | |
|-----------------------------------|--|---------------|---|---------------|--|---------------|--|---------------|
| | 1987 Appropriation (\$ In Thousands) | Percent | 1987 Appropriation (\$ In Thousands) | Percent | 1987 Appropriation (\$ In Thousands) | Percent | 1987 Appropriation (\$ In Thousands) | Percent |
| Personnel Costs | | | | | | | | |
| Permanent Positions | 1,001,257 | 62.46 | 616,085 | 54.21 | 362,038 | 28.67 | 51,397 | 54.02 |
| Positions -Non Perman. | 30,632 | 1.91 | 36,788 | 3.24 | 146,628 | 11.61 | 1,058 | 1.11 |
| Other Compensation | 9,543 | 0.60 | 30,520 | 2.69 | 16,039 | 1.27 | 2,091 | 2.20 |
| Special Personal Service | 7,457 | 0.47 | 1,718 | 0.15 | 304 | 0.02 | 43 | 0.05 |
| Personnel Benefits | 163,106 | 10.17 | 95,916 | 8.44 | 80,203 | 6.35 | 7,568 | 7.95 |
| Benefits for Former Personnel | 0 | 0.00 | 0 | 0.00 | 18,930 | 1.50 | 0 | 0.00 |
| Travel-transport. of Persons | 70,124 | 4.37 | 37,456 | 3.30 | 12,097 | 0.96 | 1,660 | 1.74 |
| Total Personnel Costs | 1,282,119 | 79.98 | 818,483 | 72.01 | 636,239 | 50.38 | 63,817 | 67.07 |
| Non-personnel Costs | | | | | | | | |
| Transportation of Things | 3,755 | 0.23 | 3,087 | 0.27 | 20,485 | 1.62 | 298 | 0.31 |
| Standard Level User Charges | 101,188 | 6.31 | 86,164 | 7.58 | 80,183 | 6.35 | 4,721 | 4.96 |
| Rental Payments to Others | 217 | 0.01 | 182 | 0.02 | 287 | 0.02 | 1 | 0.00 |
| Other Rent, Communications, Util. | 68,724 | 4.29 | 106,032 | 9.33 | 215,246 | 17.04 | 7,102 | 7.46 |
| Printing-reproduction | 12,177 | 0.76 | 9,179 | 0.81 | 72,842 | 5.77 | 263 | 0.28 |
| Other Services | 37,147 | 2.32 | 41,874 | 3.68 | 133,002 | 10.53 | 10,891 | 11.45 |
| Supplies and Materials | 12,790 | 0.80 | 8,960 | 0.79 | 28,973 | 2.29 | 2,394 | 2.52 |
| Equipment | 23,834 | 1.49 | 14,522 | 1.28 | 29,747 | 2.36 | 1,490 | 1.57 |
| Grants, Subsidies, and Contribu. | 0 | 0.00 | 2,200 | 0.19 | 0 | 0.00 | 0 | 0.00 |
| Insurance Claims and Indemnities | 175 | 0.01 | 132 | 0.01 | 103 | 0.01 | 128 | 0.13 |
| Total Non-personnel costs | 260,007 | 16.22 | 272,332 | 23.96 | 580,868 | 45.99 | 27,288 | 28.68 |
| Undistributed | 61,036 | 3.81 | 45,766 | 4.03 | 45,795 | 3.63 | 4,042 | 4.25 |
| Total Budget | 1,603,162 | 100.00 | 1,136,581 | 100.00 | 1,262,902 | 100.00 | 95,147 | 100.00 |

Source: IRS

IRS' Fiscal Year 1987 Budget Request

Comparison of Personnel and Nonpersonnel Funding

